How to use FoIs to uncover PFI/PPP contract details

Economists Jim and Margaret Cuthbert identify the key aspects of using Freedom of Information requests to uncover PFI/PPP contracts, and provide insights into how they have utilised data sources for their large portfolio of work on PFI.

At an Open the Books on PFI/PPP meeting in Edinburgh on 26 May, the suggestion was made that it would be helpful to have some information to assist with Freedom of Information requests in relation to Private Finance Initiative (PFI) and Non Profit Distribution (NPD) public-private partnership schemes. This note, which has been produced in response to that suggestion, is divided into two parts. First, we make some general points: (apologies if these are too obvious). Secondly, we list papers we have produced on PFI/NPD, noting the kinds of issues identified, and the data sources accessed in each. This is intended to illustrate what kind of issues can be illuminated by the different data sources.
General points on FOI requests

1. Making a FOI request can be a time consuming and exhausting process. The normal response will be, first, delay: and then the provision of a heavily redacted version of the requested document. Redacted versions are normally virtually useless. Unless the process is pursued through the whole gamut of appeals, (including to the Information Commissioner), useful information is unlikely to result.

2. Successful completion of the FOI request is not the end of the story. The chances of finding any obvious smoking gun are small. It is much more likely to be the case that the PFI issues will only come to light after, first getting to grips in understanding the particular PFI model: and second, using the data in the model to analyse how it actually works.

3. While FOI requests are important, it is also important to remember that there are other approaches, not involving FOI, which can throw very useful light on some issues. For example, company reports, press reports on mergers and sales, and the construction trade press contain useful information on ownership, and changes of ownership, of PFI companies.

4. While we are still living with the legacy of existing PFI schemes, new schemes in Scotland are now of the NPD type. Since a fair amount is now known about PFI, but very little is known about the characteristics of NPD schemes, (particularly those undertaken through the Scottish Futures Trust), NPD is probably a bigger priority for further research. As indeed, are the other methods used by the Scottish Futures Trust to fund capital investment.

5. It is also necessary to look beyond the issues highlighted in this note. While we hope the listing of issues and data sources in the second part of this paper is useful, in many ways what could be even more important are issues which have not yet been identified: (the unknown unknowns). One area, for example, where much further research could be done is on the effect on Scotland’s industrial base of employing PFI and NPD as a method of financing. Because of the size of many PFI projects, only large companies are capable of carrying out the projects: the likely effect has been the hollowing out of a large part of Scotland’s industrial base.

Identified issues and data sources

In this section, we list past papers of ours on PFI, to illustrate the types of issues considered, and the data sources used. Note that this is not a survey of the extensive literature on PFI. (The full texts of the papers referred to here can be found under Theme 3 on our website at www.jamcuthbert.co.uk).

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Lifting the Lid on PFI.

Questions/issues:
- Is risk actually transferred to the private sector.
- The effect of PFI on the type of project being undertaken: there have been many examples where a public authority has started off with plans for a fairly modest refurbishment, but has ended up having been convinced that what was actually required was a much more expensive new build project.
- Large scale of PFI projects: many projects are so large and complex that the degree of competition has been limited. As one supplier noted, an advantage of PFI from the supplier’s point of view was that “tender costs and complexity reduce competition”.
- High cost. For example, it became clear that many new hospitals were having to be planned on the basis of reduced bed numbers, in order to make the forecast unitary charge payments affordable.
- Inappropriate indexation of unitary charge: commonly, some simple uprate rule is applied to the unitary charge, whether as a whole or to each of its constituent parts, so that the unitary charge increases in line with inflation, or some fraction of inflation. However, using a simple uprate rule like this neglects the fact that a major part of the supplier’s financing costs, namely, debt charges, will probably not be increasing, but will be declining through time: this is because, as debt is repaid, the payment of interest each year will decline. The difference, between that increasing element of the unitary charge which covers financing costs and profit, and the declining cost of servicing debt, is available as a large profit.
- Use of inappropriate metric by public sector: internal rate of return (IRR) on its own can be a very misleading indicator of the returns actually being earned, or of the true cost of the project. Need to assess average outstanding debt on which an IRR is being earned.

Data sources:
Unredacted versions of final business cases: contracts: and full final financial projections made at the time of contract signing, (often contained as confidential annex to contract, and therefore a copy will be held by the public sector client.)

The Implications of Evidence Released Through Freedom of Information on the Projected Returns from the New Royal Infirmary of Edinburgh and Certain Other PFI Schemes

Questions/issues
- Complexity of funding: difficulty of sorting out contribution to capital funding coming from conventional sources like debt and equity, as opposed to land sales, and funding of capital direct from operational revenues.
- Whether tax which is projected to be paid to the UK government is actually paid, given that ownership of PFI schemes may be transferred to companies registered in tax havens.)

Data sources:
Full final financial projections made at the time of contract signing
The Royal Edinburgh Infirmary: A Case Study on the Workings of the Private Finance Initiative

Questions/issues

- Mistakes in risk transfer calculations: (inappropriate risks, and common risks, wrongly transferred.)
- Discount rate used for discounting costs of PFI option inappropriately high: biases comparison.
- Payments from the Trust to the PFI consortium are driven by a different metric, (bed occupancy units), from that used to drive payments from Lothian Health to the Trust (finished consultant episodes). This means that the trust is exposed to considerable financial risk, if they do not achieve their ambitious targets for increasing finished consultant episodes with a reduced number of bed occupancy units.
- The NRIE was part funded by the sale of surplus land sites. The land values were determined in 1996 and were uprated in the contract by the retail price index over the period of several years until the sales took place. There is a question as to whether this was the appropriate form of indexation.
- Termination arrangements. At the end of the initial concession period for the NRIE the consortium has very substantial residual rights. Are these unduly generous?

Data sources:
The Full Business Case, the Addendum to the Business Case and the contract papers released by Lothian Health Board under a Freedom of Information request. Of particular importance are two consultancy firms’ reports commissioned by the Lenders to the NRIE scheme, to check the financial soundness of their investment.

PFI - Refinancing

Questions/issues

Refinancing gives the owners of the PFI special purpose vehicle the potential to borrow additional funds, (such that total senior debt borrowing is substantially larger than the original cost of the project) which can be returned to shareholders. What is the scale of return being taken like this: is any of it shared with the public sector? Does the PFI company end up so seriously burdened by debt after refinancing that it increases the risk being carried by the public sector?

Data sources.
Possible data sources: the accounts of the PFI special purpose vehicles: reports in the trade press.

Analysis of the Financial Projections for Two Non-Profit Distributing PFI Schemes: and Implications

Questions/issues

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In NPD schemes, there are no dividend payments to the equity owners: instead, any final surplus in the special purpose vehicle will come to a charity specified by the authority: i.e., effectively to the public sector. There are also likely to be arrangements where any increase in the projected charitable payment during the life of the project, (denoted a "refinancing gain"), will be split between the authority and the owners of the special purpose vehicle.

- What is the relationship between the eventual charitable payment in an NPD scheme, and the initial cash balance of the project. If the initial cash balance is large, there is a danger that a large part of the charitable donation is being funded by the Authority paying for borrowing at the (relatively expensive) marginal interest rate for the project.
- There is an important issue about whether risk transfer is appropriately assessed in NPD schemes. If there is a cost increase during construction, then the financial surplus will be smaller, so the charitable donation will be reduced: in addition, the authority will also lose, since the refinancing gain it would otherwise have expected will not be available: (and the SPV owners will be worse off, because they will lose their part of the anticipated refinancing gain.) But the fact that, in these circumstances, both the authority and charity will suffer implies that important elements of risk actually rest with the public sector and the charity, rather than being confined to the private sector.

**Data sources:**
Full final financial projections made at the time of contract signing: final business case. Potentially, accounts of special purpose vehicles.

**Failure to Learn the Lessons of PFI**

**Questions/issues**
- How many compliant bids are there at the final stage of selecting a single preferred bidder. (The Treasury view is that two or fewer compliant bids at this stage is potentially indicative of a failure of competition.)
- How many of the firms involved in bidding for PFI contracts are headquartered outside Scotland.
- Are there significant delays in the bidding process: and is this associated with marked cost escalation.

**Data sources:**
Final Business Cases of all schools PPP/PFI projects in Scotland. Some of these are available on individual local authority websites: most, however, were obtained through Freedom of Information requests. The information has been supplemented by minutes of Council meetings, and by contractor bulletins on PFI.

**The Effect of PFI Commitments on Local Authority Finances**

**Questions/issues**
- How is the unitary charge indexed to allow for future variations in inflation: and does the nature of the indexation reflect the way in which the PFI consortium’s costs will vary with inflation.
- How reasonable were the assumptions made in affordability calculations? E.G., are there funding gaps later in the project life which have not been addressed? Is the authority achieving affordability in the short term by the use of temporary funding sources? Are
they making optimistic assumptions about income from land sales? Are they assuming possibly unrealistic increases in council tax?

Data sources:
final business cases, some contracts, and background documentation, including local authority audits, for all 37 Scottish local authority schools PFI projects. (Although the Scottish government stipulated that final business cases should be in the public domain, unredacted versions were often only available after pursuing FOI requests.)

How to have your cake and eat it: Government accounting for PFI
Questions/issues
- Size of potential equity profit relative to amount of risk transferred undermines whole logic of risk transfer: instead of genuine risk transfer, this could be described as the private sector having a flutter with public money.

Data sources:
Full final financial projections made at the time of contract signing: final business cases.

Who Owns Our PFI Schemes: And Why It Matters
Questions/issues
- What companies own PFI schemes in Scotland. Where are they domiciled: e.g., in tax havens. Is there evidence of undue concentration of ownership? Is there evidence of excessive profits being realised on equity sales?

Data sources:
Company information, company reports, and press reports, to determine ownership, and changes of ownership, of PFI schemes.